DOFASCO INC. ANNUAL REPORT 1985

PROFILE

Dofasco is a Canadian company with 98% of its shares held in this country. We are Canada's largest producer of flat rolled steels, providing more than 25% of the country's total steel production.

Basic products include both sheet and coils in hot and cold rolled steel, plate, galvanized steel, Galvalume steel, tinplate, chromium-coated and electrical steels, prepainted steels and steel castings. Major uses for the Company's products include automotive, appliance and agricultural industries, pipes and tubes, industrial and consumer containers, as well as residential and non-residential construction.

Dofasco's wholly-owned subsidiaries are Prudential Steel, located in Calgary, which manufactures small-diameter tubular steel products for the oil, gas and construction industries; National Steel Car, a major manufacturer of railway rolling stock located in Hamilton; and BeachviLime with its subsidiary Guelph DoLime which produce lime and limestone products.

Dofasco's iron ore mining interests include: the Adams and Sherman Mines, located in northern Ontario, Wabush Mines in Labrador with a pellet plant in Quebec, and the Iron Ore Company of Canada located in Quebec.

Dofasco also owns interests in the following companies:

- Baycoat, a Hamilton coil-coater which produces prepainted steel;
- Aberford Resources of Calgary, involved in oil and gas exploration;
- Abermin Corporation, based in Vancouver, a mineral exploration company; and
- ITL Industries Limited, located in Windsor, which manufactures a range of plastic automotive parts and plastic moulding equipment.

Contents

On pourra se procurer le texte français de ce rapport annuel en s'adressant au secrétaire de la Société, case postale 460, Hamilton, Ontario L8N 3J5.

HIGHLIGHTS

	1985	1984	Increase (Decrease)
Production of ingots and castings – net tons*	**4,373**	4,468	(2.1%)
Shipments of flat rolled products, semi-finished steel and steel castings – net tons*	**3,258**	3,319	(1.8%)
Sales*	**$1,993,584**	$1,926,172	3.5%
Net income*	**$ 170,094**	$ 180,605	(5.8%)
Net income attributable to common shares*†	**$ 144,773**	$ 174,593	(17.1%)
Net income – per common share†	**$ 2.77**	$ 3.47	(20.2%)
Dividends declared – per common share	**$ .92**	$ .84	9.5%
Net income after adding back interest on long term debt (after taxes) – percent of average capital employed	**9.2%**	11.1%	(17.1%)
Net income – percent of average common shareholders' equity†	**12.5%**	17.2%	(27.3%)
Capital expenditures* – manufacturing	**$ 189,356**	$ 84,012	125.4%
– mine and quarry	**$ 5,609**	$ 6,824	(17.8%)
Working capital*	**$1,005,273**	$ 696,778	44.3%
Shareholders' equity*	**$1,575,488**	$1,159,878	35.8%
Average number of employees	**13,600**	13,200	3.0%

**in thousands*
†after preferred dividends

STOCK MARKET INFORMATION

Common Shares

Year	High	Low	Shares traded
1985	**$29¾**	**$23⅜**	**14,028,735**
1984*	$25½	$17⅜	13,803,179
1983	$63	$34	4,559,868
1982	$41⅝	$26⅞	2,882,633
1981	$49½	$37½	1,686,065

**The figures for 1984 reflect the effect of the 3 for 1 stock split of January 24, 1984.*

Valuation day (December 22, 1971) share prices: Common $25.00 (without taking into account the 3 for 1 stock split of January 24, 1984); Class A preferred $74.00.

MESSAGE TO SHAREHOLDERS

Nineteen eighty-five was a good year although net income of $170 million was $11 million lower than the record earnings of the previous year. Consolidated sales were $2.0 billion, compared to $1.9 billion in 1984.

Throughout the year demand for most of Dofasco's products was firm and the steel plant operated near capacity levels. The first half of 1985 was excellent, led by a strong performance from automotive markets, increased activity in the consumer and energy sectors and a general strengthening of the economy. Although we maintained satisfactory operating rates during the second half of the year, earnings declined under increasingly competitive market conditions.

The results at our subsidiaries were mixed. Operating levels at National Steel Car remained low because of the lack of demand for railway cars. Prudential Steel's performance improved to good levels in 1985 due to strengthening in Canada's oil and gas industry.

In recent years steel markets have become more competitive as customers require higher quality products and the best possible service. This is a continuing challenge and part of our response is to get the best available equipment and technology. Since 1970 we have invested more than $1.5 billion towards this end. Between now and the early 1990's, we expect to spend an additional $2 billion to upgrade and expand our operations. Part of this expenditure is the $750 million project to introduce continuous casting at Dofasco, which we are moving ahead with as quickly as possible.

While state-of-the-art equipment is important, another major factor in Dofasco's progress has been our employees' fine record in responding to changing needs. As part of our ongoing program, nearly 1,200 employees at all levels received instruction in statistical process control techniques and problem solving during the year. We are applying new technology together with further employee skills development to serve customers more effectively, reduce costs and maintain our position in the marketplace.

We issued $325 million of convertible preferred shares in April of 1985 to provide funds for new facilities as well as for potential acquisitions or investments in steel-related or other businesses. As part of our financing arrangements for the current continuous casting program, negotiations were completed in November with Mitsui & Co., Ltd. to provide for long term borrowing of up to $303 million at favourable interest rates.

During the year, meetings were held with representatives from our industry and the Canadian and U.S. federal governments to discuss concerns about the level of steel imports entering the United States. Canadian steel shipments to that country were monitored during the year. While the product mix changed due to market demands, the total shipments remained comparable to 1984 levels.

In our meetings with U.S. officials we emphasized that, for every dollar's worth of Canadian steel sold in the U.S., our industry buys approximately $1.30 worth of U.S. materials and supplies. We do not expect Dofasco's ability to trade with the U.S. to be adversely affected by any decisions made to date and we are continuing to monitor the situation.

The weakness of overseas currencies during much of 1985 contributed to an upward trend in steel imports into the Canadian market. This trend could continue if Canada becomes an alternate market for foreign steel diverted from the United States because of American import restrictions. This issue is under active discussion with our Federal Government.

Outlook

During the first few months of 1986 demand for most flat rolled products has remained strong and we expect to maintain good operating rates at least through midyear. The automotive and energy sectors may decline slightly from their 1985 performance. However, we expect this to be offset by further improvements in other markets such as housing and non-residential construction. Overall, we expect domestic demand for flat rolled products to be comparable to 1985 levels.

Management Changes

We were all saddened by the loss of two long-time Dofasco associates in 1985.

In March, David Lindsey, Vice President – Raw Materials, Purchases and Traffic passed away. David had been with Dofasco for 46 years, his entire working life. His experience and dedication over the years contributed significantly to the Company's success and he is greatly missed by his many friends and colleagues.

Harold Rea passed away in June. Harold was a well known and distinguished Canadian who served for 20 years as a member of Dofasco's Board of Directors. Over the years his wise counsel was a valuable asset to the Company.

John McMulkin retired in August after 38 years with Dofasco. Over his career, John made a valuable contribution to the development of the Company. At the time of his retirement John was Vice President – Research.

In June, several senior appointments were approved by the Board of Directors.

John McAllister was appointed Vice President – Raw Materials, Purchases and Traffic. John joined Dofasco in 1959 and was Director – Raw Materials, Purchases and Traffic prior to this latest appointment.

Bill Mulveney became Vice President – Sales. Bill began his career with Dofasco in 1958 and most recently held the position of General Manager – Sales.

Noel Thomas became Vice President – Technology. Noel also started with Dofasco in 1958 and was previously Director – Research.

Larry Walsh was named Vice President – Works Manager. Larry joined Dofasco in 1966 and most recently held the position of Works Manager.

On behalf of the Board of Directors we extend thanks to our shareholders, customers and suppliers for their continued support. We also wish to express appreciation to our employees for their dedication and performance throughout the year.

Frank Sherman

Frank Sherman
Chairman and Chief Executive Officer

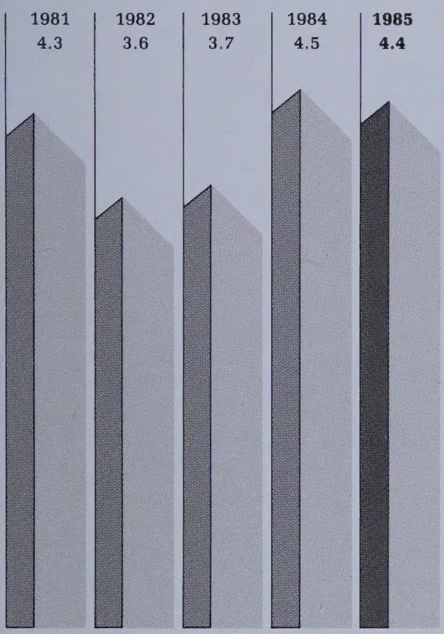
Paul Phoenix

Paul Phoenix
President and Chief Operating Officer

Hamilton, Ontario March 7, 1986


DOMINION
Ben
THINGHOLM

OPERATIONS



Ingot and Castings Production
(in millions of net tons)

Photo: *Twenty-year veteran roller Ben Thingholm led a 1985 task force of maintenance, inspection, automation and production specialists who looked at new ways of manipulating giant rolls to improve gauge accuracy to meet customers' more demanding needs. For our customers and the task force, every thousandth of an inch gained is a significant step forward.*

Dofasco produced 4.4 million tons of ingots and castings in 1985, compared to 4.5 million tons in the previous year. The change in raw steel production from the record set in 1984 was primarily the result of scheduled repairs to three of our blast furnaces. Rolling and finishing facilities operated at or near capacity throughout the year.

No. 4 Blast Furnace is scheduled to be rebuilt this summer. Significant modifications to this facility will improve the operation of the furnace. Additional ingots have been placed in inventory to allow normal rolling and finishing to continue during the three and a half month construction period.

In 1985 we used 5.1 million net tons of iron ore pellets and 2.1 million net tons of coal. All of the ore was obtained from Canadian sources. Our coal requirements were nearly all purchased in the United States due to the coal quality and the proximity of U.S. mines to our steel operations. Dofasco's subsidiaries, BeachviLime and Guelph DoLime, supplied most of the Company's lime and limestone requirements.

Prudential Steel's production of pipe products increased over 1984 as the oil and gas sector strengthened. However, National Steel Car and our foundry operated at low levels as the result of a continuing decline in demand from the railway sector. As a result, we have been forced to cut back our foundry operation significantly. This will result in reduced employment in that division, but all affected employees are being provided with job opportunities in our steelmaking facilities.

New Facilities
As part of our program to maintain Dofasco's competitive position as a world-class steel producer, we are spending $750 million on new facilities which include:

- a two-strand continuous slab caster, capable of producing slabs suitable for rolling into a wide range of products;
- related modifications to No. 2 Steelmaking Plant, including a ladle metallurgy station to provide better control over steel chemistry and temperature prior to casting;
- two reheating furnaces to prepare slabs for hot rolling;
- two additional finishing stands, coilers and coil conveyors for the No. 2 Hot Strip Mill to enable the mill to roll a broader range of products; and
- roll grinding and related facilities in No. 2 Hot Strip Mill to improve roll handling and maintenance.

This program is designed to help us to maintain Dofasco's position as the leading supplier of flat rolled products to the domestic market and to expand our capability to meet the new and more demanding end uses for steel in the future. The facilities are expected to be completed by the third quarter of 1987.

No. 4 Pickle Line started up in December and is capable of processing a wide range of flat rolled products. The line reduces our dependency on outside pickling and will improve our product quality and customer service.

During the year, the capacity of our Central Shipping facilities was expanded by 50% to provide faster and more flexible handling of finished products.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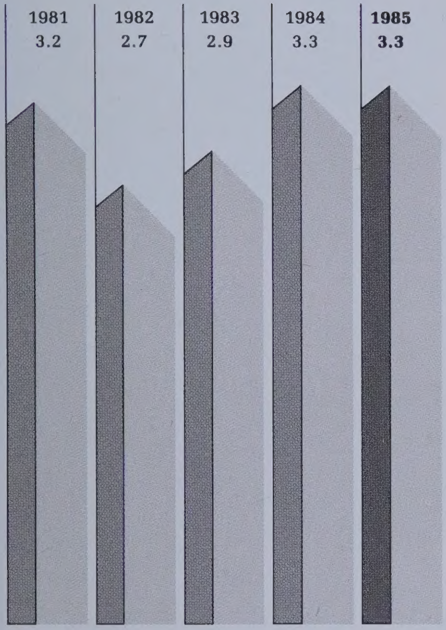

Shipments of flat rolled products, semi-finished steel and steel castings (in millions of net tons)

Photo: *Dofasco's Bronco Jazvac, Denis Piggot and Larry Budjan (left to right) help develop this self-elevating transporter. The new transporters include many unique features to improve the efficiency of handling the pallets used to move steel coils and ingots throughout our plant.*

Performance

Consolidated sales for 1985 were $2.0 billion, up slightly from 1984 record levels. Total shipments of flat rolled steel products were 3.2 million tons, unchanged from the previous year.

Domestic demand for Dofasco's flat rolled products was good during the first half of the year. This was due primarily to a strong performance from the automotive sector and improved levels of activity in the other consumer-related, construction, energy and steel service centre markets.

During the second half of the year demand remained strong for our cold rolled and coated products. However, orders for hot rolled steel eased somewhat due to a reduction in automotive requirements, customer inventory adjustments and an increasingly competitive Canadian marketplace.

Outlook

The economy shows signs of modest improvement in 1986. While the automotive and energy sectors are expected to decline slightly, we anticipate a continuing recovery in business investment, and in the housing and non-residential construction industries. Consumer spending should remain at or near 1985 levels.

Overall Canadian demand for flat rolled products should be comparable to 1985. Our bookings for galvanized steel should remain strong at least through midyear. Dofasco's newest product, Galvalume steel, is gaining market acceptance and sales are expected to be substantially higher than in 1985.

Orders for cold rolled steel should be good through the first half of 1986 with demand broadly based. Tinplate sales to traditional markets are expected to remain near 1985 levels. Any improvement in hot rolled sales will depend primarily on the performance of the automotive and the pipe and tube industries, as well as our ability to improve our market share in this product area.

While National Steel Car is actively seeking orders for new business, the current outlook for at least the first half of 1986 is poor.

Prudential Steel's business has been reasonably good through the first quarter and we expect this to continue to mid year. However, it is difficult to assess the potential impact of the Western Energy Accord and the expiry of the Federal Petroleum Incentive Program grants on the demand for Prudential's products.


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PROCESS AND PRODUCT TECHNOLOGY

Photos: *Left, To improve coating consistency on Dofasco's galvanizing lines, a team of electronic technologists including (left to right) Dave Hartman, Frank Ditomaso and Peter Ross, designed and built a data concentrator. The concentrator is part of a computer system which monitors and controls the thickness of the zinc coating as it's applied to sheet steel. Notes Frank, "Sometimes you can't buy what you need – so you design it yourself."*

Above, A protective coating of zinc is applied to a continuous strip of steel at the No. 2 Galvanizing Line.

Dofasco's technical efforts throughout 1985 focussed largely on improvement of product quality and reduction of operating costs.

The introduction of pre-fluxed pellets to the ironmaking operations has provided significant energy savings and productivity increases at our blast furnaces. These specially formulated iron ore pellets are made at our mines. Additional savings have resulted from improved operating practices developed by our people to obtain higher iron yields.

In 1985 we concluded negotiations for the introduction of the KOBM/KMS process. The equipment will be installed at our No. 2 Steelmaking Plant later this year. This technology allows bottom stirring in the steelmaking vessel for more uniform steel chemistry and increased use of steel scrap.

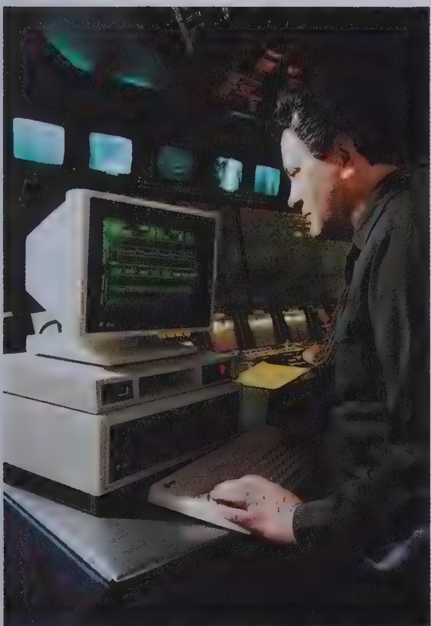
Our research and operating departments have devised an effective control technique which reduces vibration in high speed tandem cold mills. This allows greater productivity through higher rolling speeds as well as more uniform product thickness.

Broader application of computer technology is helping improve product quality and productivity throughout our operations. For example, the equipment in our cast slab program will include extensive custom-designed computer controls to assist our operators in running these new facilities. Our people are also currently evaluating the benefits offered by a computer-aided design (CAD) system.

Close contact with the automotive and container industries has allowed us to tailor new products to meet their specific needs. Working directly with our automotive customers, we have extended our range of coated and uncoated high strength, low alloy steels for use in automobiles.


MEASURE.
METHOD
PERSON
SPEED
mpg
STARTS
Charles Terry
Fred Goetz
Larry

EMPLOYEES



Photos: Left, Bill Brooks, Supervisor of Dofasco's Quality Training Centre, leads a Statistical Process Control class. "I tell our people SPC is a new tool box," says Bill, "one they'll have at their fingertips from now on. SPC gives us the tools to improve quality on an ongoing basis."

Above, Computer displays in Dofasco's rolling mills describe how accurately the process is under control. Adjustments can be made immediately when necessary.

Over the years, Dofasco people have been skillful and dedicated in responding to the changing needs of the marketplace. To build on these strengths, a series of training programs in Statistical Process Control (SPC) was developed. During the year nearly 1,200 Dofasco employees completed one or more SPC courses and over 3,500 have taken a seminar stressing quality improvement through management techniques and problem-solving.

Our people are now applying these new skills in their daily work throughout the Company. Continuing training will help ensure that employees are well-equipped to do their jobs effectively and efficiently.

In 1985 more than 250 employees took part in various supervisory education programs. These courses were designed to address specific supervisory requirements in certain operating areas. Over the years, over 3,000 people have taken courses which include the development of leadership, counselling and communications skills.

Community involvement has always been important for many Dofasco employees. As well as contributing their own time and skills in aid of many worthwhile community organizations, our employees gave more than $1 million in 1985 through the Dofasco Employee Donations Fund. This is a significant increase over 1984. A large portion of these contributions went to the United Way and its 58 member agencies. Substantial support was also given to several area hospitals which are undertaking major expansion and modernization programs.

Participation in the 49th year of the Dofasco Suggestion System increased substantially with nearly 5,000 suggestions submitted during the year. More than $400,000 was paid in awards to employees whose ideas were adopted. These are very good results and we are proud of our employees' initiative.

FINANCIAL REVIEW

Consolidated net income in 1985 was $170 million, down 5.8% from 1984. After payment of preferred dividends, net income applicable to common shares was $145 million and earnings per common share were $2.77. Return on shareholders' equity was 12.5%.

Earnings for 1985 were less than the previous year's record due to a number of factors. While sales were up slightly, this improvement was more than offset by increased costs and very competitive market conditions, which affected our ability to increase prices. However, we are confident that our programs to improve product quality and our major investment in new facilities will result in lower overall costs.

National Steel Car's income was low because the market for railway rolling stock continued to be severely depressed throughout 1985. However, BeachviLime had a record year and Prudential Steel's earnings increased substantially with improving energy-related activity in western Canada.

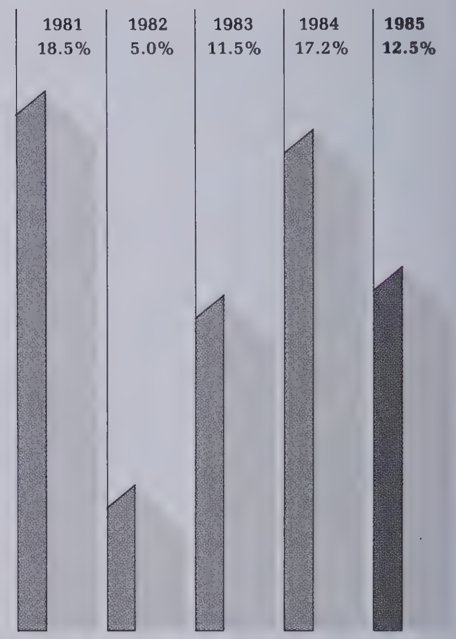
In April, 1985 the Company issued $325 million of $2.60 Convertible Class C Preferred Shares. The net proceeds from this new share issue are available to be spent on new plant facilities and on other investment opportunities which may be identified.

To provide some of the capital required to finance the continuous casting program, Dofasco entered into a financing agreement with Mitsui & Co., Ltd. Under this arrangement, up to $303 million of long term borrowing is available to Dofasco at an average interest rate of 9.95%.

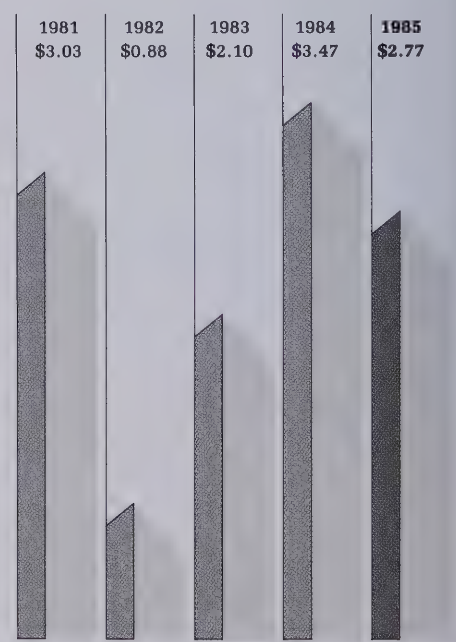
In January, 1986 the outstanding $2.35 Class B Preferred Shares were redeemed for $54 million. This share redemption will decrease preferred dividend payments.

Capital expenditures in 1985 were $195 million, compared to $91 million in 1984. At year end, commitments for completion of authorized capital projects totalled $846 million. Major capital investments made in 1985 include $52 million for the No. 4 Pickle Line, $85 million for the continuous casting program and $17 million for expansion of the Central Shipping facility.

Other investments made during the year include the purchase of 20% of the shares of ITL Industries Limited, a manufacturer of plastic automotive components as well as plastic moulding tools and dies. Dofasco's ownership in Aberford Resources Limited was increased from 6.3% to 12.5%. Following the reorganization at Aberford, we received a 12.1% interest in its newly-formed sister company, Abermin Corporation. These investments totalled $26 million and through our participation on the boards of directors of these companies, they provide us with better knowledge of the plastics and natural resource industries.



Return on common shareholders' equity
(after preferred dividends)



Net income – Dollars per common share
(after preferred dividends)

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

(in thousands of dollars)

for year ended December 31, 1985
(with comparative figures for 1984)

INCOME

	1985	1984
Revenues		
Sales	**$1,993,584**	$1,926,172
Interest and other income	**44,234**	26,478
	2,037,818	1,952,650
Expenses		
Cost of sales (before the following items)	**1,612,242**	1,515,764
Depreciation and amortization	**94,585**	89,613
Employees' profit sharing (note 13)	**22,420**	25,282
Interest on long term debt	**37,777**	37,486
	1,767,024	1,668,145
Income before income taxes	**270,794**	284,505
Income taxes (note 8)	**100,700**	103,900
Net income for year	**$ 170,094**	$ 180,605

RETAINED EARNINGS

	1985	1984
Balance at beginning of year	**$ 952,084**	$ 819,603
Add:		
Net income for year	**170,094**	180,605
Discount on preferred shares purchased for cancellation	**21**	194
	1,122,199	1,000,402
Deduct:		
Dividends declared –		
Preferred shares	**25,321**	6,012
Common shares	**48,150**	42,306
Cost of issuing Class C preferred shares, net of tax	**5,566**	—
	79,037	48,318
Balance at end of year	**$1,043,162**	$ 952,084

EARNINGS AND DIVIDENDS

	1985	1984
Net income for year	**$ 170,094**	$ 180,605
Deduct preferred dividends – Class A preferred	**797**	803
– Class B preferred	**5,095**	5,209
– Class C preferred	**19,429**	—
	25,321	6,012
Net income attributable to common shares	**$ 144,773**	$ 174,593
Net income per common share (note 9)		
Basic	**$ 2.77**	$ 3.47
Fully diluted	**$ 2.70**	$ 3.32
Dividends declared per common share (including stock dividends having a substantially equivalent value)	**$ .92**	$ .84

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(in thousands of dollars)

December 31, 1985
(with comparative figures at December 31, 1984)

	1985	1984
CURRENT ASSETS		
Cash and short term investments	$ 533,189	$ 217,104
Accounts receivable	238,186	239,319
Inventories (note 2)	579,905	547,383
	1,351,280	1,003,806
CURRENT LIABILITIES		
Accounts payable and accrued charges	237,546	191,570
Amounts payable for employees' profit sharing	22,420	25,282
Income and other taxes payable	10,367	75,985
Dividends payable	17,282	10,691
Current requirements on long term debt (note 5)	4,402	3,500
Obligation to redeem preferred shares (note 6)	53,990	—
	346,007	307,028
WORKING CAPITAL	1,005,273	696,778
Fixed assets (note 3)	1,274,707	1,174,327
Investments	40,923	22,196
Unamortized financing expenses	6,561	3,948
CAPITAL EMPLOYED	2,327,464	1,897,249
Deduct:		
Long term liabilities (note 5)	390,876	382,971
Income tax allocations relating to future years	361,100	354,400
	751,976	737,371
SHAREHOLDERS' EQUITY	$1,575,488	$1,159,878
Represented by:		
Preferred shares (note 6)	$ 341,762	$ 71,565
Common shares (note 7)	187,470	133,768
Dividends distributable in common shares	3,094	2,461
Retained earnings	1,043,162	952,084
	$1,575,488	$1,159,878

On behalf of the Board:

F H Sherman

Director

J Reitzel

Director

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands of dollars)

for year ended December 31, 1985
(with comparative figures for 1984)

	1985	1984
CASH DERIVED FROM OPERATIONS (note 11)	**$ 200,107**	$ 177,418
CASH USED FOR INVESTMENT ACTIVITIES		
New facilities and equipment (after deducting investment tax credits, 1985 – $12,934, 1984 – $5,424) –		
Manufacturing	**166,093**	77,055
Mine and quarry	**5,609**	6,824
Increase (decrease) in long term investments	**18,727**	(568)
	190,429	83,311
DIVIDENDS PAID	**66,247**	48,736
CASH DERIVED FROM (USED FOR) FINANCING ACTIVITIES		
Class C preferred shares issued, less related costs	**319,434**	—
Notes payable issued, less related costs	**11,729**	—
Common shares issued	**53,702**	15,732
Reduction in long term debt	**(11,419)**	(15,728)
Reduction in preferred shares	**(792)**	(152,073)
	372,654	(152,069)
TOTAL INCREASE (DECREASE) IN CASH	**316,085**	(106,698)
Cash and short term investments –		
Balance at beginning of year	**217,104**	323,802
Balance at end of year	**$ 533,189**	$ 217,104

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1985

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles consistently applied. They are based on information available to January 30, 1986 and are within the framework of the accounting policies summarized below:

(1) Accounting policies

(a) Basis of consolidation –
The consolidated financial statements include the accounts of the Corporation's wholly-owned subsidiaries (National Steel Car Limited, Prudential Steel Ltd. and BeachviLime Limited), as well as the Corporation's proportionate share of the assets, liabilities and results of operations of its joint venture activities (Sherman Mine, Wabush Mines and Baycoat Limited). Other long term investments (including Aberford Resources Limited and Iron Ore Company of Canada) are carried at cost.

(b) Inventories –
Inventories of materials, supplies, semi-finished and finished products are valued at the lower of average cost and net realizable value. Physical inventory quantities are determined at least annually by actual examination or, for certain raw materials, by aerial survey.

(c) Fixed assets –
Fixed assets are recorded at their historical cost, which includes the cost of installation, less related investment tax credits.
Depreciation is computed generally by the straight-line method applied to the cost of the assets at rates based on their estimated useful lives, as follows:

Buildings .... 2.5 to 5%
Equipment .... 6 to 7.5%
Automotive................ 20 to 25%
Mine and quarry
– processing facilities ..... 4.5 to 5%
– heavy mobile equipment 4.5 to 20%

(d) Repair and maintenance costs –
Repair and maintenance costs are expensed as incurred except for the estimated cost of relining blast furnaces which is accrued over the period between relines.

(e) Income taxes –
The Corporation follows the tax allocation method of providing for income taxes. Under this method, timing differences between reported and taxable income result in "Income tax allocations relating to future years".

(2) Inventories

	$000's	
	1985	1984
Materials and supplies	$ 253,017	$ 271,204
Semi-finished and finished products	326,888	276,179
	$ 579,905	$ 547,383

(3) Fixed assets

	$000's	
	1985	1984
Facilities and equipment –		
Manufacturing	$1,879,143	$1,814,563
Mine and quarry	208,294	206,289
	2,087,437	2,020,852
Less accumulated depreciation and amortization	1,007,174	917,117
	1,080,263	1,103,735
Construction in progress	194,444	70,592
	$1,274,707	$1,174,327

(4) Joint ventures

The Corporation received a pro rata share of iron ore pellets produced by two joint ventures (Sherman Mine and Wabush Mines) in return for paying its proportionate share of costs. The normal expenses incurred by the joint ventures are included in the cost of materials produced and ultimately are reflected as cost of sales when finished products are sold.

A third joint venture is Baycoat Limited, a coil coating operation, in which the Corporation has a 50% interest. The Corporation reflects its share of revenues and expenses of this joint venture in the consolidated statement of income.

The Corporation's net investment in these joint ventures (included in the consolidated statement of financial position categories to which they relate) is summarized below:

	$000's	
	1985	1984
Working capital	$ 2,590	$ 1,780
Fixed assets	37,340	42,581
Investments	3,264	3,409
	43,194	47,770
Income tax allocations relating to future years	1,579	1,639
Net investment	$ 41,615	$ 46,131

(5) Long term liabilities

	$000's	
	1985	1984
Debt		
Sinking fund debentures –		
6½% due May 15, 1987	$ 17,150	$ 17,150
9% due February 1, 1991	27,846	29,140
10% due June 1, 1994	29,393	30,708
10⅞% due May 15, 1995	38,604	40,720
10⅜% due March 15, 1996	41,064	42,755
9⅜% due February 15, 1997	63,147	64,650
17% due May 1, 1997	56,500	60,000
13½% due November 1, 2000	47,222	47,222
	320,926	332,345
Notes payable	14,841	—
Total long term debt at December 31	335,767	332,345
Less current requirements	4,402	3,500
	331,365	328,845
Accrued liability for relining blast furnaces beyond one year	59,511	54,126
	$ 390,876	$ 382,971

Requirements for repayment of long term debt within the next five years are as follows:
1986 – $4.4 million; 1987 – $22.9 million; 1988 – $12.9 million; 1989 – $17.8 million; 1990 – $17.9 million.

On November 12, 1985, the Corporation entered into a financing agreement for up to $303 million in connection with the program to produce continuously cast slabs. Under the terms of the agreement, funds will be advanced as construction progresses for which the Corporation will issue notes payable. If the full amount is advanced, the notes will have an average annual interest rate of 9.95%. Repayment will be made by equal semi-annual instalments beginning five years after the completion of construction and ending by November, 2003.

The Corporation has revolving bank credit available until December 31, 1993 in the amount of $150 million in Canadian funds together with an additional $50 million in either Canadian or U.S. funds. None of the revolving credit was used during 1985.

(6) Preferred shares

Authorized – preferred shares issuable in series:

Class A preferred shares – 500,000
Class B preferred shares – unlimited
Class C preferred shares – unlimited

Issued less redeemed:	1985 Shares	1985 $000's	1984 $000's
Class A preferred shares 4¾% cumulative redeemable preferred shares, Series A	167,624	$16,762	$ 16,837
Class B preferred shares $2.35 cumulative redeemable preferred shares, 1980 Series	2,159,600	53,990	54,728
Class C preferred shares $2.60 cumulative redeemable voting convertible preferred shares, Series 1	10,000,000	325,000	—
Total preferred shares at December 31		395,752	71,565
Less current obligation to redeem Class B preferred shares, 1980 Series		53,990	—
		$341,762	$ 71,565

Class A preferred shares

The Corporation is in compliance with its obligation to retire at least 2% of the outstanding Class A preferred shares per year. To December 31, 1985, 82,376 shares have been purchased for cancellation (including 750 shares during 1985 for $44,000).

Class B preferred shares

To December 31, 1985, 240,400 shares have been purchased for cancellation (including 29,500 shares during 1985 for $748,000).

On January 15, 1986 the Corporation redeemed all outstanding Class B preferred shares, 1980 series at $25.00 per share. The obligation to redeem these shares, in the amount of $53,990,000, has been included as a current liability in the consolidated statement of financial position at December 31, 1985.

Class C preferred shares

On April 2, 1985, the Corporation issued 10,000,000 Series 1, $2.60 cumulative, redeemable, voting preferred shares for $325 million cash. They are convertible into Dofasco common shares on a share for share basis until the earlier of April 1, 1995 or the day on which such shares are redeemed.

The preferred shares are redeemable under specified conditions at the option of the Corporation after March 31, 1990 and prior to April 1, 1995 at $34.00 per share plus accrued and unpaid dividends. After March 31, 1995, the Corporation may redeem the preferred shares for $32.50 per share plus accrued and unpaid dividends.

Commencing April 1, 1995, the Corporation will, in each calendar quarter, make all reasonable efforts to purchase 1% of the total number of convertible preferred shares then outstanding at a price not to exceed $32.50 per share plus accrued and unpaid dividends.

(7) Common shares
Authorized – unlimited
Issued – 53,945,068

Changes in the outstanding common shares during each of the past two years are summarized below:

	Number of Shares	Value
		($000's)
Outstanding at December 31, 1983	49,762,290	$118,036
Shares issued as dividends:		
Stock dividends	36,756	747
Dividend Reinvestment Plan	395,986	7,792
Shares issued for cash:		
Employee stock option plan	257,424	2,949
Share Purchase Plan	15,191	313
Conversion of warrants	259,176	3,931
Outstanding at December 31, 1984	50,726,823	$133,768
Shares issued as dividends:		
Stock dividends	24,072	625
Dividend Reinvestment Plan	447,024	10,581
Shares issued for cash:		
Employee stock option plans	148,998	2,887
Share Purchase Plan	21,154	524
Conversion of warrants	2,576,997	39,085
Outstanding at December 31, 1985	53,945,068	$187,470

By articles of amendment, effective May 1, 1985, the Class A and Class B common shares were reclassified into a single class of common shares.

Holders of the reclassified common shares may elect to receive, in lieu of any cash dividend declared on the common shares, a stock dividend of common shares having a value substantially equivalent to the cash dividend otherwise payable.

There are two employee stock option plans. Under the first plan, which expires on March 1, 1994, the Board of Directors granted options to certain employees of the Corporation to purchase, in the aggregate, 236,736 unissued common shares at $18.00 per share. No further options will be granted under this plan. The second plan, which expires on September 6, 1994, authorizes the directors to grant options to certain employees of the Corporation to purchase, in the aggregate, up to 4,000,000 unissued common shares. The number of options granted to each optionee is related to the optionee's remuneration during the option period and therefore cannot be determined until the last year of the plan.

At December 31, 1985, options to purchase 516,234 common shares were outstanding as follows:

Option Price per Share	Options Outstanding
$18.00	76,014
$22.75	440,220

No options are granted to directors who are not full-time employees of the Corporation.

(8) Income taxes

The provision for income taxes reflects an effective tax rate which differs from the combined federal and provincial tax rate. The difference is reconciled as follows:

	1985	1984
Combined basic federal and provincial income tax rate	51.5%	51.0%
Less decreases resulting from:		
Manufacturing and processing tax credit	(5.1)	(5.4)
Resource and depletion allowances net of mining tax	(5.0)	(4.8)
Inventory allowance	(2.7)	(2.0)
Other	(1.5)	(2.3)
	(14.3)	(14.5)
Effective income tax rate	37.2%	36.5%

The amounts provided for income taxes consist of:

	$000's	
	1985	1984
Current	$ 94,000	$118,800
Allocations relating to future years	6,700	(14,900)
	$100,700	$103,900

(9) Net income per common share
Net income per common share has been calculated on the basis of net income for the year less preferred dividends, divided by the monthly weighted average number of common shares outstanding during the year. The calculation of fully diluted net income per common share assumes that all Class C convertible preferred shares were converted at date of issue, April 2, 1985 and all outstanding stock options and warrants were exercised at the beginning of the year. The calculation includes an allowance for imputed interest derived from the investment of funds which would have been received.

(10) Segmented information
In accordance with statutory requirements, the Board of Directors has determined that the Corporation and its subsidiaries are engaged in one line of business involving basic steel production and fabrication. Export sales for 1985 totalled $236 million ($264 million in 1984).

(11) Cash derived from operations
Cash derived from operations is reconciled as follows:

	$000's	
	1985	1984
Net income for year	$170,094	$180,605
Items not involving cash –		
Depreciation and amortization	94,585	89,613
Income tax allocations relating to future years	6,700	(14,900)
Change in accrued liability for relining blast furnaces	5,385	(2,120)
Other	499	505
Additional operating working capital requirements utilizing cash	(77,156)	(76,285)
	$200,107	$177,418

(12) Related party transactions
Mr. J. D. Leitch, a director of Dofasco, is an officer and director of ULS International Inc. During 1985 the Corporation was required by contract to offer ULS International Inc. its entire requirements for water transport of the Corporation's bulk raw materials to Hamilton, and ULS International Inc. was required to provide such transport. Freight charges, negotiated annually, amounted to $25 million in 1985 (1984 – $29 million).
At December 31, 1985, the Corporation owed ULS International Inc. $1,331,000 (1984 – $743,000).

(13) Employees' profit sharing on steelmaking operations
The Corporation allocates 11% of steelmaking profits before income taxes to the Dofasco Employees' Savings and Profit Sharing Fund and the Dofasco Employees' Deferred Profit Sharing Plan.

(14) Retirement plans
The Corporation funds retirement plans covering substantially all of the employees. Pension costs charged against income during the year, based on amounts estimated by independent actuaries, include amounts for current and past service. There are no unfunded liabilities with respect to past service pension costs at December 31, 1985.

(15) Commitments
The estimated amount required to complete authorized capital projects, including an allowance for the effect of continuing inflation, is $846 million at December 31, 1985. Most of these expenditures will be incurred over the next three years.

AUDITORS' REPORT

To the Shareholders of Dofasco Inc.:
We have examined the consolidated statement of financial position of Dofasco Inc. as at December 31, 1985 and the consolidated statements of income, retained earnings and cash flows for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Hamilton, Canada
January 30, 1986.

Clarkson Gordon
Chartered Accountants

TEN YEAR SUMMARY OF PRODUCTION AND FINANCIAL DATA

	1985	1984	1983
STATEMENT OF INCOME DATA*			
Sales	**$1,993,584**	$1,926,172	$1,605,696
Interest and other income	**$ 44,234**	$ 26,478	$ 22,926
Cost of sales (before the following items)	**$1,612,242**	$1,515,764	$1,285,271
Depreciation and amortization	**$ 94,585**	$ 89,613	$ 77,961
Employees' profit sharing	**$ 22,420**	$ 25,282	$ 20,833
Interest on long term debt	**$ 37,777**	$ 37,486	$ 42,575
Income before income taxes	**$ 270,794**	$ 284,505	$ 201,982
Income taxes	**$ 100,700**	$ 103,900	$ 81,500
Net income for the year	**$ 170,094**	$ 180,605	$ 120,482
Net income attributable to common shares†	**$ 144,773**	$ 174,593	$ 103,608
FINANCIAL POSITION DATA*			
Working capital	**$1,005,273**	$ 696,778	$ 586,782
Fixed assets – land, buildings and equipment, at cost	**$2,281,881**	$2,091,444	$2,003,689
– accumulated depreciation	**$1,007,174**	$ 917,117	$ 830,585
Total other assets	**$ 47,484**	$ 26,144	$ 27,217
Capital employed	**$2,327,464**	$1,897,249	$1,787,103
Long term liabilities	**$ 390,876**	$ 382,971	$ 404,319
Income tax allocations relating to future years	**$ 361,100**	$ 354,400	$ 369,300
Total shareholders' equity	**$1,575,488**	$1,159,878	$1,013,484
STATISTICAL DATA			
Production of ingots and castings – net tons*	**4,373**	4,468	3,700
Shipments of flat rolled products, semi-finished steel and steel castings – net tons*	**3,258**	3,319	2,858
Net income per common share†‡	**$ 2.77**	$ 3.47	$ 2.10
Net income – percent of sales†	**7.3%**	9.1%	6.5%
Net income after adding back interest on long term debt (after taxes) – percent of average capital employed	**9.2%**	11.1%	8.0%
Net income – percent of average common shareholders' equity†	**12.5%**	17.2%	11.5%
Net book value per common share‡	**$ 22.87**	$ 21.45	$ 18.88
Dividends declared			
– per common share‡	**$ .92**	$ .84	$ .69
– per Class A preferred share	**$ 4.75**	$ 4.75	$ 4.75
– per Class B, Series 1, 2 and 3 preferred share	**—**	—	$ 1.783
– per Class B, $2.35 preferred share	**$ 2.35**	$ 2.35	$ 2.35
– per Class C, $2.60 preferred share	**$ 1.94**	—	—
Income reinvested in the business*	**$ 96,623**	$ 132,287	$ 69,474
Capital expenditures* – manufacturing	**$ 189,356**	$ 84,012	$ 49,809
– mine and quarry	**$ 5,609**	$ 6,824	$ 2,551
Total dividends declared* – preferred	**$ 25,321**	$ 6,012	$ 16,874
– common	**$ 48,150**	$ 42,306	$ 34,134
Number of holders of common shares	**11,086**	11,237	11,438
Percentage of common shares held in Canada	**97.6%**	97.1%	96.7%
Average number of employees	**13,600**	13,200	11,400

**in thousands*
†after preferred dividends
‡restated to include the effect of the 3 for 1 stock split

1982	1981	1980	1979	1978	1977	1976
$1,485,557	$1,767,509	$1,541,914	$1,435,058	$1,120,383	$ 919,036	$ 904,958
$ 21,252	$ 39,675	$ 21,914	$ 19,602	$ 12,418	$ 12,759	$ 4,981
$1,288,304	$1,407,802	$1,257,306	$1,117,388	$ 892,125	$ 752,151	$ 739,144
$ 79,089	$ 74,003	$ 65,634	$ 64,876	$ 53,370	$ 47,063	$ 42,108
$ 6,921	$ 22,884	$ 14,705	$ 20,479	$ 13,189	$ 8,529	$ 8,652
$ 39,584	$ 33,721	$ 32,339	$ 32,672	$ 35,195	$ 34,434	$ 23,736
$ 92,911	$ 268,774	$ 193,844	$ 219,245	$ 138,922	$ 89,618	$ 96,299
$ 29,100	$ 99,500	$ 71,600	$ 82,300	$ 44,000	$ 21,100	$ 29,600
$ 63,811	$ 169,274	$ 122,244	$ 136,945	$ 94,922	$ 68,518	$ 66,699
$ 42,767	$ 147,070	$ 107,304	$ 125,191	$ 85,437	$ 63,103	$ 65,728
$ 593,286	$ 567,717	$ 600,070	$ 526,462	$ 429,983	$ 430,800	$ 260,666
$2,011,224	$1,878,404	$1,647,826	$1,466,910	$1,399,767	$1,269,245	$1,112,987
$ 774,720	$ 701,113	$ 645,776	$ 584,941	$ 524,911	$ 475,144	$ 431,896
$ 16,371	$ 13,271	$ 9,034	$ 8,811	$ 10,004	$ 10,937	$ 12,185
$1,846,161	$1,758,279	$1,611,154	$1,417,242	$1,314,843	$1,235,838	$ 953,942
$ 430,401	$ 372,760	$ 371,291	$ 333,869	$ 368,996	$ 379,277	$ 297,665
$ 332,200	$ 308,800	$ 271,200	$ 246,700	$ 206,500	$ 177,700	$ 165,300
$1,083,560	$1,076,719	$ 968,663	$ 836,673	$ 739,347	$ 678,861	$ 490,977
3,636	4,258	3,681	4,060	3,588	3,333	3,335
2,682	3,223	2,914	3,099	2,830	2,596	2,652
$ .88	$ 3.03	$ 2.22	$ 2.63	$ 1.81	$ 1.34	$ 1.39
2.9%	8.3%	7.0%	8.7%	7.6%	6.9%	7.3%
5.0%	11.3%	9.4%	11.5%	9.3%	8.7%	9.3%
5.0%	18.5%	15.2%	20.2%	15.8%	12.9%	14.6%
$ 17.56	$ 17.45	$ 15.28	$ 13.95	$ 12.04	$ 10.77	$ 9.96
$ .75	$ .83	$ .81	$ .70	$ .55	$ .52	$ .49
$ 4.75	$ 4.75	$ 4.75	$ 4.75	$ 4.75	$ 4.75	$ 4.75
$ 2.457	$ 2.629	$ 2.108	$ 1.808	$ 1.427	$ .744	—
$ 2.35	$ 2.35	$ .58¾	—	—	—	—
—	—	—	—	—	—	—
$ 6,169	$ 106,571	$ 68,283	$ 91,814	$ 59,317	$ 38,116	$ 42,615
$ 133,050	$ 238,259	$ 176,848	$ 61,257	$ 128,205	$ 152,168	$ 77,411
$ 5,252	$ 10,985	$ 8,867	$ 10,732	$ 5,920	$ 7,906	$ 36,534
$ 21,044	$ 22,204	$ 14,940	$ 11,754	$ 9,485	$ 5,415	$ 971
$ 36,598	$ 40,499	$ 39,021	$ 33,377	$ 26,120	$ 24,414	$ 23,113
12,866	13,451	13,719	14,141	14,674	15,196	15,298
97.2%	97.0%	96.6%	97.2%	97.1%	97.1%	97.1%
12,700	13,700	14,100	13,700	12,300	11,300	11,500

OWNERSHIP INTERESTS

	Percentage Ownership
Subsidiaries	
National Steel Car Limited, Hamilton, Ontario*	
A manufacturer of railway rolling stock, industrial and mining specialty rail cars and car parts.	
R. W. Cooke, President and Chief Executive Officer	100.0%
Prudential Steel Ltd., Calgary, Alberta*	
A manufacturer of electric resistance weld pipe in the 2″ to 10″ range; tubing and casing for the oil and gas industry; hollow structural steel for agricultural and industrial uses. Its subsidiary Cardinal Tube Coatings Ltd. applies corrosion protection wrapping to oil and gas line pipe.	
J. S. Badyk – Chairman	100.0%
BeachviLime Limited, Beachville, Ontario*	
A quarry and processing operation supplying lime and limestone products. Its subsidiary Guelph DoLime Limited produces dolomitic lime.	
J. H. McAllister – President	100.0%
Iron ore mining and pelletizing	
Adams Mine, Kirkland Lake, Ontario*	
Cliffs of Canada, Ltd. – Manager	100.0%
Sherman Mine, Temagami, Ontario*	
Cliffs of Canada, Ltd. – Manager	90.0%
Wabush Mines*, comprising:	
Scully Mine, Wabush, Newfoundland	
Pelletizing plant, Pointe Noire, Quebec	
Pickands Mather & Co. – Manager	16.4%
Iron Ore Company of Canada†, comprising:	
Carol Project, Labrador City, Newfoundland	
Rail and dock facilities, Sept-Iles, Quebec	
Hanna Mining Co. – Managing agents	6.1%
Other investments	
Baycoat Limited, Hamilton, Ontario*	50.0%
ITL Industries Limited, Ontario†	20.0%
Arnaud Railway Company, Quebec†	16.4%
Wabush Lake Railway Company, Limited, Newfoundland†	16.4%
Aberford Resources Limited, Alberta†	12.5%
Abermin Corporation, Vancouver†	12.1%
Knoll Lake Minerals Limited, Newfoundland†	9.5%
Northern Land Company Limited, Newfoundland†	8.2%
Twin Falls Power Corporation, Limited, Newfoundland†	2.8%

Transfer Agents and Registrars

National Trust Company –
Toronto, Montreal, Vancouver, Winnipeg, Calgary, Regina

Canada Trust – Halifax

The Bank of Nova Scotia Trust Company of New York – New York

**Ownership interest consolidated in Financial Statements.*
†Included under "Investments" in Financial Statements.

DIRECTORS

George H. Blumenauer
Chairman of the Board
Otis Canada, Inc.
Oakville

R. Ross Craig
Vice Chairman

Roger G. Doe
Senior Partner, Campbell,
Godfrey & Lewtas
Toronto

Robert C. Dowsett
Vice Chairman,
William M. Mercer Limited
Toronto

John R. Evans
Chairman and Chief Executive
Officer
Allelix Inc.
Toronto

Howard J. Lang
Corporate Director
Toronto

John D. Leitch
Chairman, ULS International Inc.
Toronto

Frank H. Logan
Vice-Chairman, Canadian
Imperial Bank of Commerce
Toronto

Paul J. Phoenix
President and Chief Operating
Officer

John G. Sheppard
Vice Chairman

Frank H. Sherman
Chairman and Chief Executive
Officer

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Frank H. Sherman
Chairman and Chief Executive
Officer

R. Ross Craig
Vice Chairman

John G. Sheppard
Vice Chairman

Paul J. Phoenix
President and Chief Operating
Officer

William L. Wallace
Executive Vice President

William D. Simon
Senior Vice President –
Commercial

Thomas Van Zuiden
Senior Vice President – Finance
and Administration

David H. Samson
Vice President – Engineering

H. Graham Wilson
Vice President and Secretary

William P. Tinsley
Vice President – Personnel

John W. Craven
Vice President – Quality

John H. McAllister
Vice President – Raw Materials,
Purchases and Traffic

William H. Mulveney
Vice President – Sales

Noel G. Thomas
Vice President – Technology

Lawrence V. Walsh
Vice President – Works Manager

Bill P. Solski
Treasurer

Robert W. Grunow
Comptroller

Robert J. Swenor
Assistant Secretary

L. Allen Root
Assistant Treasurer

R. Eric Moore
Assistant Comptroller

John J. Fitzpatrick
Assistant Comptroller

DOFASCO

Our product is steel. Our strength is people.